SME FINANCING IN DOLLARISED-MUILTICURRENCY SYSTEM: ZIMBABWE CASE STUDY

A Dissertation

presented to

The **Development Finance Centre (DEFIC)**
Graduate School of Business
University of Cape Town

In partial fulfilment
of the requirements for the Degree of
Master of Commerce in Development Finance

by

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11 FEBRUARY, 2019

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DECLARATION

I, Tawanda Mudamburi, student number MDMTAW001 do hereby declare that this dissertation is my own original work with the exception of quotations and references that are attributed on their sources and this thesis has not been previously submitted and will not be presented to any university for similar or any other degree programme.

Signature: Signed by candidate Date: 11 February 2019

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DEDICATION

I wholly dedicate this dissertation to my wife Madeline, our three children and my mother Mrs. Uintah Mudamburi for their sterling support rendered during the production of this dissertation.

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ACKNOWLEDGEMENTS

First and foremost, I would like to extend my profound acknowledgements to my supervisor Dr Mundia Kabinga for his expert scrutiny and professional guidance during the compilation of this dissertation. Without your thorough supervision, the production of this dissertation would not have been a reality. Thank you so much. May the Almighty Lord abundantly bless you.

ABSTRACT

The research was carried out with the objective of establishing an ideal source of capital for Small and Medium Enterprises (SMEs) financing in a dollarized multicurrency system. The overarching research question was premised on whether equity is the ideal source of capital over debt capital for SMEs financing. The Pecking Order and Credit Rationing Models were used to assess whether SMEs should consider outside or inside finance and again whether the ideal source of capital should be debt or equity. The research document introduced the demand side data set of the Pecking Order Model and supply side of Credit Rationing Model to fill this gap. The models were used as a benchmark in the analysis of quantitative data which were computed using the Statiscal Package for Social Sciences (SPSS) and qualitative data which were content analyzed. Quantitative data were collected from a sample of 113 respondents comprising of 60 SMEs from Gazaland Home Industry in Harare and 53 officials from purposively sample institutions that have been financing and/or providing capacity building to SMEs. The overall findings from the research study showed that dollarization and multicurrency system like other global financial crises affected SMEs financing specifically debt capital and as such SMEs have been surviving based on their ability to mobilize internal savings and new equity injections. The conclusion drawn and recommendations proffered point to the need for government and the central bank to explore venture capital as an alternative source of equity capital for SMEs financing.

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List of acronyms

SMEs	Small and Medium Enterprises
ZIMASSET	Zimbabwe Agenda for Sustainable, Social and Economic Transformation
GDP	Gross Domestic Product
RBZ	Reserve bank of Zimbabwe
SMEDCO	Small and Medium Enterprises Development Corporation
HPAEs	High Performing Asian Economies
IPO	Initial Public Offering
VC	Venture Capital
VCF	Venture Capital Firms
MITI	Ministry of Industry and International Trade
VEC	Venture Enterprise Centre
IFC	International Finance Corporation
ZNCC	Zimbabwe national Chamber of Commerce
ZYC	Zimbabwe Youth Council
UNWTC	United Nations World Trade Conference
ZEPARU	Zimbabwe Economic Policy and Research Analysis Unit
SMEAZ	Small and Medium Association of Zimbabwe
CBZ	Commercial bank of Zimbabwe
CZI	Confederation of Zimbabwe Industries
IBWO	Indigenous Business Women Organisation
MSME	Micro Small and Medium Enterprises
POSB	Post office Savings Bank
MFI	Micro Finance Institution

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CHAPTER 1: INTRODUCTION

1.1 **Introduction and Background**

The main purpose of this research study is to explore an ideal source of capital for SMEs financing in the context of dollarisation in Zimbabwe. In Zimbabwe the multicurrency system has been hurting the growth and development of SMEs due to unavailability of capital by financial institutions for both investment and working capital projects. The World Bank Report (2015b) shows that Zimbabwe's financial sector has been subjected to several distress periods both before and after dollarisation multicurrency system in 2009. The introduction of the bond note in 2014 for example, has resulted in the shrinking of the financial sector, a scenario that has affected the level of SMEs financing by banks (Sachikonye and Sibanda, 2016). Thus simply because a country dollarizes says nothing about its capital adequacy. Hira & Dean (2004) argued that dollarization can cause potential damage to marginalised groups within development society such as SMEs. Literature has shown that SMEs in Latin American countries like El Salvador, Guatemala, Ecuador and Argentina that adopted the United States (US) dollar as legal tender have continued to face challenges in accessing finance.

The Zimbabwean economy was affected by severe challenges such as hyperinflation which resulted in sharp decline in the value of the Zimbabwean dollar. The hyperinflationary environment between 2008 and 2009 which almost put the Zimbabwean economy to a halt was mainly attributed to the land reform program and the government's reckless spending which resulted in unbudgeted expenditure. Specifically, the resolution to support the war in the Democratic Republic of Congo (DRC) in 1998 and the expropriation of land from white commercial farmers progressively resulted in higher rates of inflation. As pointed out by Chiimbi (2005), the Reserve Bank of Zimbabwe (RBZ)'s quasi-fiscal programs also fuelled inflation due to rapid increase in the bank's deposits and local currency M3. Thus the government's weak fiscal and monetary policies were the major causes of hyperinflation. Inflation reached a record high of 417 823 percent in March 2009 and this culminated in the de facto dollarization of the economy and which was made official in 2009.

Specifically after dollarisation, the financial sector in Zimbabwe has been characterised by episodes of financial repression that include among others, liquidity problems, circulation of funds outside the banking system, inadequate capitalisation, non-performing loans and financial inclusiveness. Chigumira and Makochekanwa (2014) argued that these financial repression episodes characterised by low savings adversely affected the quality and quantity of investment as bankers adopted credit-rationing policies and practices. In a paper titled "SMEs Financing by Commercial Banks in Zimbabwe," Sachikonye & Sibanda (2016), revealed that banks in Zimbabwe have been facing several systematic challenges that include a general illiquidity in the market, absence of long term capital, high costs of internally mobilised funds, low capitalisation, increased level of non-performing loans and plummeting banking services. The challenges have resulted in serious cash shortages, which have eroded banks' ability to underwrite business particularly to SMEs which are considered risky enterprises. The financial services sector in the country has a critical role to play in the promotion of the growth and development of SMEs in Zimbabwe (Dhliwayo, 2014).

Exploring the ideal source of capital is critical in assisting SMEs accessing capital under the current adverse multicurrency system which according to the World Bank Report (2015a), has caused the shrinking of the country's financial sector business which in turn has a bearing on the level of SME financing. Credit risk has been a major concern for banks in Zimbabwe and this has resulted in banks' reluctance to lend to SMEs. For instance, effective lending rates by commercial banks in Zimbabwe ranged from 13-38% per annum in January 2018 (World Bank, 2015b). In order to mitigate against default risks, banks in the country charge a risk premium on loans to SMEs, resulting in high borrowing costs. This phenomenon of credit rationing has mostly affected SMEs than large corporates (Duan, Han and Yang, 2009). It is again critical to reiterate that whilst the country adopted a multicurrency system, regional and international lines of credit remained subdued thereby affecting the level of financing of risky businesses such as SMEs (Malaba, 2014).

To put it into context, it is crucial to point out that unlike in Latin America, Zimbabwe's position was quite complicated in that the country was under economic sanctions when it dollarised resulting in it not being backed by foreign currency reserves. The adoption of the multicurrency system and in particular after the 2013 elections, the country started experiencing liquidity challenges which severely affected SMEs' ability to access debt capital. According to Noko (2011), the liquidity challenges being experienced by SMEs across all sectors of the economy have been attributed to lack of the country's financial integration with the global economy. For instance, foreign banks have been unwilling to loan local banks and companies with money to ease credit shortages. This is clear testimony that in the absence of capital from the international community, imbalances between dollar inflows and outflows will always exist.

Literature has also shown that Panama the first country to dollarize in 1904 experienced severe liquidity challenges between 1987 and 1989 as a result of the tension between the United States government and Panama (Agnoli, 2002). As a result of the tension, 11 percent of the deposits were withdrawn from the banking system and this drastically reduced lending to the SME sector. This confirms the fact that SMEs normally face severe challenges in accessing formal sources of external finance during crisis periods (Beck and Demirguc-Kunt, 2006). Research by Daskalakis (2013) also confirms the same conclusion about how SMEs in Eurorised economies such as Greece have faced difficulties in accessing external finance.

Yeyati (2006) defines dollarisation by resolving it into two groups. Official dollarisation (*de jure*) refers to a case in which foreign currency is given legal tender status whilst unofficial (*de facto*) dollarisation is used to indicate the use of a foreign currency alongside the national currency when the former is not legal tender. In turn *de facto* dollarisation is also resolved into currency substitution (use of foreign currency as a medium of exchange) and asset substitution (its use as a store of value). Another scholar, Dean (2001; 2002) also defines the two types of dollarization that is *de facto* and *de jure*. De facto dollarisation is spontaneous adoption of the dollar (or any foreign currency) by the general public without supporting government legislation, a process which has been well underway in Latin America for many years. De jure dollarization by contrast entails government legitimisation which may range from simply declaring the dollar as legal tender to withdrawing all domestic currency and/or abolishing all other legal tender.

1.2 The Research Problem

Zimbabwe started experiencing liquidity challenges after the adoption of multicurrency system which in turn severely affected SMEs access to finance especially debt capital. Thus whilst the SME sector is viewed as an important contributor to the economy of Zimbabwe and significant generator of employment, the sector has been facing serious financing challenges after dollarisation, a position attributed mainly to credit rationing. Earlier studies, Abor and Quartey (2010), Karlan and Valdivia (2011), Drexler et al. (2014), Aghion and Bolton (1997), Kevane and Wydick (2001), Schiffer and Weder (2001), Cressey (2002), Beck et al. (2008) and Lois and Annette (2005) among others have examined SMEs sources of capital. They all have shown that access to external finance is a major obstacle for small firms especially in countries with underdeveloped financial and legal systems. However none of these research studies have examined SME financing in the context of either dollarisation or multicurrency system. The Pecking Order Theory (Myers and Majluf, 1984) for instance, only argues that firms usually prefer internal sources (personal savings and retained profits) over other financial services. The theory does not look at the preference of sources of capital in the context of either dollarisation or a multicurrency system. Therefore the aim of this research study is to fill the gap by critically examining the appropriate sources of capital (debt and equity) for SMEs in a dollarisation economy.

1.3 Research Questions

- The overarching research question is premised on whether equity capital is the ideal source of capital over debt capital for driving SMEs growth and transformation in a dollarised multicurrency system economy.
- How does dollarization affect SME sources of equity and debt capital?
- What are the formal sources of finance (debt and equity) available for SMEs in a dollarized economy?

1.4 **Research Objectives**

The study sought:

- To explore an ideal source of capital (debt and equity) for SMEs in a dollarised multicurrency system.
- To find out how dollarisation affect SMEs sources of debt and equity capital.
- To explore alternative formal sources of capital available for SMEs in the context of dollarisation.

1.5 **Justification of the Study**

The country's financial sector has been subjected to episodes of financial repression that include liquidity problems, circulation of funds outside the banking system, inadequate capitalisation, non-performing loans and lack of financial inclusiveness among others. Stieglitz and Weiss (1981) pointed out that the Pecking Order may arise due to external debt being subject to credit rationing and other supply constraints. In light of the financial crisis and cash crisis that have been bedevilling the country at large and SMEs in particular after dollarisation multicurrency system, this study will contribute immensely in helping SMEs in making relevant and appropriate financing decisions needed to spearhead their growth and transformation. Many studies and business surveys have identified access to finance as the most essential catalyst for spearheading the development, growth and survival of SMEs (Beck and Demirguc-Kunt, 2006). The SME sector is the sector of the economy that helps many economies of the world to limit the economic decline. Ball et al, (2010:67) argue that almost every economy that has attained major economic growth had a concentrated drive towards the creation of viable and scalable SME enterprises. For example economic giants such as China, South Korea and Malaysia have used SMEs development as a catalyst for their growth and development.

It is abundantly clear that SMEs are now an indispensable component of the economy of Zimbabwe through their sustainable development programs such as employment creation, poverty alleviation and significant contribution to GDP. Beck et al. (2005a) pointed out that there is a robust, positive relationship between the relative size of the SME sector and economic growth. Thus finding the appropriate source of capital under the current environment will spearhead the financing and transformation of SMEs based at Gazaland Home Industry in Harare where SMEs have been struggling to access capital. In spite of the benefits dollarization, financial challenges have continued to inhibit many SMEs from realising their full potential and from contributing significantly towards national development. To the best of my knowledge, no study has empirically explored these issues particularly in the context of dollarization multicurrency in Africa. Therefore this research study aims at filling the gap by examining the appropriate and relevant sources of capital for SMEs growth and development in a dollarized multicurrency system.

This study will also be of great benefit to the Zimbabwean government which has been committing large sums of money towards the development and growth of SMEs. According to Mangudya (2017), the FinScope SME Survey Report (2012) shows that SMEs in Zimbabwe employ approximately 5, 7 million people and contributes more than 60% of the country's GDP. Finding the appropriate source of capital under the current dollarized multicurrency system is critical in transforming SMEs in line with Zimbabwe Agenda for Sustainable, Social and Economic Transformation (ZIMASSET) blue.

1.6 Organisation/Structure of the study

Chapter 1 introduced the research and background of the study. It went on to discuss the research objectives, research questions, research hypothesis, justification as well as the scope of the study. Chapter 2 reviewed the literature and other related issues expounded by many scholars on SMEs financing in the context of dollarisation. Chapter 3 focused on the research design, research philosophy, research framework, research strategies, study population as well as sampling techniques and size used. Chapter 4 focused on the analysis and interpretation of results obtained from data collected. In particular the chapter demonstrated the long term trend of SME financing in a dollarized multicurrency system. Chapter 5 summarised and concluded the study. Based on findings and discussions, recommendations were made for SME financing in the context of dollarization multicurrency.

CHAPTER 2: LITERATURE REVIEW

2.1 INTERNATIONAL DIMENSION

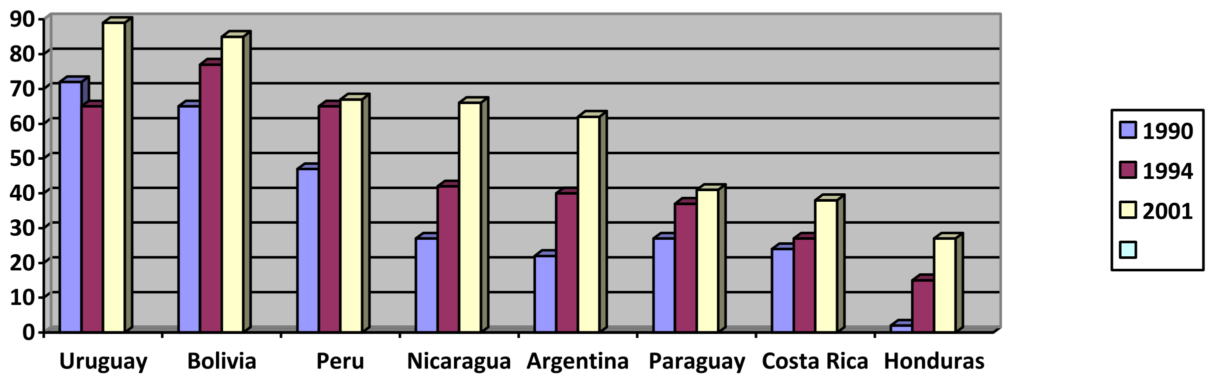
SMEs unlike big firms face the inherent challenge of being denied loans during financial crisis periods. According to Hallberg (2000), the financial crisis periods of the 1990s in Latin America and East Asia confirm this proposition. Also the SME Performance Review (EC, 2009) reported that SMEs were facing difficulties in accessing finance in the aftermath of the global financial crisis. Access to finance is a significant obstacle for SMEs during crisis periods such as the current dollarization multicurrency system in Zimbabwe. Ardic, Mylenko and Saltane (2012) confirm that historically SMEs unlike large firms were denied new loans during financial crisis periods. More recently in the aftermath of the global financial crisis, the SME Performance Review (EC, 2009) gives anecdotal evidence pointing to the difficulties associated with SME financing during crisis periods. According to the same report, a broad range of other factors such as the capacity of the banking sector and the financial sector are also linked to SME growth and development. Exploring the ideal source of finance will help in coming up with long term SMEs financing and investment decisions.

In spite of the importance of SMEs for job creation and production, numerous studies that use firm-level survey data demonstrate that access to finance and the cost of credit pose as barriers to SME financing and also constrain SMEs more that large firms. SMEs find it challenging to obtain commercial bank financing, especially long-term loans, for several reasons that include among others lack of collateral, difficulties in proving creditworthiness, small cash flows, inadequate credit history, high risk premiums, underdeveloped bank-borrower relationships and high transaction costs.

Hallberg (2000) pointed out that the sector that is most affected in accessing finance in times of financial crisis periods is the SMEs. The experiences of countries in Latin America like Panama, Ecuador and El Salvador among others have shown that whilst dollarisation can help economies achieve lower inflation, economic stability and growth, literature has also shown that dollarization brought about liquidity challenges to some of these countries which negatively affected SMEs in accessing finance. For example Agnoli (2002) cited Panama the first country to dollarise in 1904 experienced severe liquidity challenges between 1987 and 1989 as a result of the tension between the United States government and Panama government (Agnoli, 2002). As a result of tension, 11 percent of local deposits were withdrawn from the banking system and this drastically reduced lending to the SME sector. As a result after dollarisation banks started employing prudent banking practices through credit rationing to risk businesses such as SMEs. This case scenario confirms the Zimbabwe situation where after dollarisation the country could not access external lines. The degree of dollarization is measured by deposits in foreign currency as a percentage of total liquidity.

Figure 1 below highlights partial dollarisation in Latin America Foreign currency deposits as a percentage of total liquidity.

Figure 1



Source: Central bank of each country.

In a Eurorised economy such as Greece, SMEs also faced challenges in accessing external finance. Evidence has shown that access to finance is a significant obstacle for SMEs during crisis periods. In Greece, literature has shown that in terms of Equity financing, SMEs rely mostly on their own funds (Daskalakis, 2013). The SMEs in Greece have been reluctant in using new external investors such as business angels and venture capital. Thus these SMEs would not want to raise new Equity finance from sources outside the family. There is also substantial evidence that SMEs have less access to formal sources of external finance during crisis periods (Beck and Demirguc-Kunt, 2006).

In terms of getting bank loans for financing, SMEs in Greece preferred to use long term debt. However as alluded earlier, literature has shown that there are limitations which prevent SMEs from accessing long-term loans in that country. Research has shown that SMEs in Greece follow the perking order financing approach in financing their enterprises (Daskalakis, 2013). The rationale behind using the Pecking Order Model has been about avoiding high agency costs associated with debt finance and the fear of losing control in the case of taking external equity. In terms of grant financing, this has been earmarked for micro firms which receive state grants and co-funded programs.

According to Yeyati (2006), literature on dollarisation has mainly focused on Latin American countries where earlier work on currency substitution was experienced due to high inflation. The literature has clearly shown that in financially dollarized economies there is a challenge of unstable demand for money and a greater probability of banking crisis which in turn has a bearing on SMEs access to debt and equity capital. Jameson (2001) argued and attributed the capital challenges that SMEs face in dollarized economies mainly to the unwillingness of the United States to act as a lender of last resort for the dollarized economies during financial crisis periods. For example, Jameson (2001) has shown that even the IMF itself was willing to allow Ecuador after dollarization to default on Brady bonds without taking a formal position. This on its own is a clear testimony for a weakened support for a dollarized country which in turn eroded the liquidity capacity of banks to underwrite loans to risky businesses like SMEs.

2.2 REGIONAL DIMENSION

In Tanzania literature has shown that out of the many problems affecting SMEs, access to external finance has been cited as the greatest. A survey of 136 SMEs found that 63 percent cited challenges in accessing finance from formal financial institutions as the major constraint for SMEs growth and development (Satta, 2006). The reasons why SMEs face challenges in accessing finance is that they are constrained by high risk and transaction costs brought about by information asymmetry, difficulties in enforcing contracts and lack of appropriate instruments to manage the risk involved. In some cases, the challenges are aggravated by capital adequacy requirements that restrict banks from extending uncollaterised loans to SMEs (Wright, 2000). Satta (2006) argued that there is need for SMEs in developing economies with limited finances to consider recapitalising their enterprises through existing financial sources such as microfinance finance banks who are readily available to provide the money through relationship banking.

Herani and Qureshi (2011) highlighted that statistics show that 99 % (3 million) of enterprises in Pakistan are SMEs and as in many developing economies, the SME sector is essential as it contributes 30 % to the gross domestic product (GDP). Whilst Pakistan has a sound banking infrastructure, SMEs continue to rely on informal sources of finance. This is mainly because the formal sector is bureaucratic and involves lengthy documentation, collateral, borrowing costs, and other requirements. According to the World Bank (2009), the SMEs which have obtained formal credit from the banking sector in Pakistan is 7 % compared to 33 % in India and 32 % in Bangladesh. This is mainly because the formal banking sector in Pakistan is bureaucratic and involves lengthy documentation, collateral, borrowing costs, and other requirements.

In Ghana restrictions of loans to SMEs have largely been attributed to information asymmetry. Thus banks prefer borrowers who have a good track record of profitability, some degree of longevity, long term banking relationships and assets that can be used as collateral (Berger and Udell; Cole and Wolken 1995; Ennew and Binks 1995; Weinberg 1994). The banks employ strategies to minimise defaults by loan borrowers. To reflect the greater uncertainty of repayment, banks may raise the interest rates on loans to riskier borrowers like SMEs businesses (Berger and Udell 1995). Tagoe et al. (2005) also highlighted that access to affordable credit over a reasonable period is the main financial challenge for SMEs in Ghana.

According to results of a survey research conducted by Abor (2004), bank loans account for less than a quarter of SMEs total debt financing in Ghana. The results also reveal that profitability is significantly and negatively related to bank loan. Whilst there is a growing recognition of the importance of SMEs to economic growth, however these SMEs often encounter challenges in financing their enterprises. According to Biekpe (2004), most SMEs especially in Sub-Saharan Africa, fail in their first year due to lack of support from government and traditional banks. According to Abor and Biekpe (2007), bank financing accounts for less than a quarter of the total debt financing of SMEs in Ghana.

Whilst many African economies have realised the critical role that SMEs play especially in terms of employment creation, they have also realised that these SMEs face a myriad of financing and operational challenges when compared to their counterparts in the larger formal organizations. In the current business environment SMEs are a bed rock for economic development. In Africa, 90% of the business operate as SMEs and offer more than 50% of employment as well as contributing 50% of the GDP. Schiffer and Weder (2001), Cressy (2002) and Beck et al. (2008) have all stressed that the role of SMEs in economic development has been limited by lack of access to financial services, especially from formal financial services. International researchers such as Abor and Quartey (2010) stressed the importance of SMEs in developing economies in promoting economic development. World Bank (2015) pointed out that SMEs contribute up to 45 per cent of the total employment and 33 per cent of the national income in developing economies.

Wolf, 2007; Bloom et al., (2010) pointed out that financial constraints particularly among SMEs have received much more attention in recent times. This is because evidence abounds that lack of finance stifles innovations, investment in physical capital and new technology that are likely to stimulate productivity growth (Wolf, 2007; The World Bank, 2008). Although formal banks are believed to have a wider scale, offer large size and longer term loans, they have restricted access to SMEs because of perception of risks and high transaction costs of delivery (Beck and Demirguc-Kunt, 2006). In Zimbabwe in spite of the interventions from MFIs and mainstream commercial banks, the majority of MSEs, particularly at start-ups remained severely constrained after dollarisation. Thus, they are forced to often rely on limited household savings (self-raised), remittances or even donation from charitable organisations as well as sometimes on informal finance, which are known to charge exorbitantly high interest rates (Osei-Assibey, 2010).

In Ghana although formal banks are believed to have a wider scale, offer large size and longer term loans, they have long restricted access to SMEs because of perception of risks and high transaction costs of delivery (Beck and Demirguc-Kunt, 2006). In Ghana, despite interventions from MFIs and mainstream commercial banks, the majority of SMEs, particularly at start-ups, are still severely constrained. Thus, they are forced to often rely on limited household savings (self-raised), remittances or even donation from charitable organisations as well as sometimes on informal finance, which are known to charge exorbitantly high interest rates (Osei-Assibey, 2011). Wolf, 2007; Bloom et al., (2010) evidence abounds that lack of finance stifles innovations, investment in physical capital and new technology that are likely to stimulate productivity growth (Wolf,2007;The World Bank, 2008). These research studies have clearly shown that information asymmetry is the greatest impediment towards SMEs financing specifically external financing.

2.3 ZIMBABWE DIMENSION

In the Zimbabwean context, the adoption of dollarization multicurrency system had an adverse effect on the provision of loan facilities to the SMEs sector by banks. Stiglitz and Weiss's Credit Rationing model argued that credit rationing is a symptom of a mismatch between demand and supply of credit caused to a large extent by information asymmetry. Foreign currency and cash shortages due to failure to access external lines of credit coupled with the introduction of the bond note caused a lot of distortions in the financial market resulting in banks rationing credit to the SME sector. Sachikonye and Sibanda (2016), pointed out that the current operating environment characterised by foreign currency and cash shortages has resulted in the shrinking of the financial services sector resulting in the rationing of credit facilities to SME sector. Under the prevailing macroeconomic environment, banks need reliable information about the creditworthiness of customers before extending loan facilities.

While access to capital has always been a challenge for SMEs growth and development in Zimbabwe, this issue became more pronounced when the country adopted a multicurrency system (dollarisation) in 2009 and internationally after the global financial crisis of 2008 to 2009. For example the crisis periods of the 1990 in dollarised countries in Latin America and East Asia confirm this position (Hallberg, 2000). Thus access to capital became a significant challenge for SMEs financing when the country dollarized. Ardic, Mylenko and Saltane (2012) argue that SMEs access to capital and cost of credit not only pose as inherent limitations to SMEs financing but also constrain SMEs business more than large firms. For instance one strand of literature on the subject of SMEs finance indicates that SMEs pay higher interest rates on formal bank credit than large firms. SMEs find it difficult under dollarization to obtain commercial bank financing especially long term loans due to various reasons inter alia; lack of collateral, insufficient credit history, high risk premiums and high transaction costs among other limiting factors. SMEs have are more likely than larger firms to denied new loans during financial crisis than large firms.

In line with the demand side data set of Pecking Order theory as espoused by Myers and Majluf (1984), the fundamental question for SMEs in Zimbabwe is whether to consider inside or outside finance and again whether the ideal source of capital should be debt or equity capital. The Pecking Order theory points out that when SMEs are in need of additional funds, retained earnings will be preferred over debt and that debt will be preferred over new share issues to outsiders. SMEs in the country have been failing to access loan facilities after dollarization because they lacked collateral security. Avery et al. (1998) as supported by Berger and Udell (1998) pointed out that entrepreneurs in developing countries need to have significant personal wealth (net worthy) that can be used as collateral for securing debt finance. In contrast the same report has shown that in developed markets, households, SMEs and firms can easily access loans at reasonable cost and at the same time there is a diverse range of credit facilities offered by both banking and non-banking financial institutions.

The World Bank (2015a) report shows that the challenges that have been facing the financial services sector in Zimbabwe include among others illiquid market, high costs of capital mobilisation particularly internally, low capitalisation and increased level of non-performing loans and these have affected lending to SMEs. Thus dollarization multicurrency system has been affecting the lending capacity of banks to the SMEs sector mainly due to the absence of international and regional lines of credit which have remained subdued. Duan, Han and Yang (2009) pointed out that the phenomenon of credit rationing mainly affects SMEs when compared with established firms. Ocran (2012) argued that lenders in developing countries are saddled with high transaction costs for lending to SMEs especially during periods of financial crisis. The author further emphasised that the absence of critical financial infrastructure such as Credit Registries/ bureaux has resulted in increased information asymmetry between the lender and borrower of developing economies.

SMEs in Zimbabwe require more financial and technical support that is if meaningful economic development and growth is to be attained. Whilst financial institutions in the country are supposed to play a critical in financing SMEs, they have not been financially equipped to deal with the challenge due to the absence of external lines of credit from international financial institutions. This resulted in the credit market remaining subdued thereby causing banks to charge high risk premiums on loans to SMEs resulting in high borrowing costs (Finmark Trust, 2014).The cash and liquidity constraints led to the erosion of banks' ability to underwrite business specifically to SMEs which are considered risky. Thus financial institutions in the country have been severely affected by the illiquid market which has resulted in cash shortages. Commercial banks in the country have a significant role to play in the promotion of the development of SMEs (Dhliwayo, 2014).

Whilst Zimbabwe adopted multicurrency in its basket of currencies (bond note, rand, pula, dollar) in reality, the country dollarised since all these other currencies were used alongside the US dollar. According to Noko (2011) dollarisation allowed Zimbabwe to quash hyperinflation (from 231 million% in June 2008 to 3% in June 2011), restore stability, increase budgetary discipline, re-establish monetary credibility and contribute to economic growth. However empirical evidence found that volatility in accessing capital has been significantly higher in dollarized countries compared to non-dollarized economies (Edwards and Magenzo, 2006). Dollarisation has a consistent and negative impact on financial deepening (the availability of funds provided by financial intermediaries to individuals, firms and governments). This has been found to have negative bearing on credit extension to SMEs businesses. Agnoli (2002) argued that the effects of dollarisation differ depending on the degree of financial integration of the domestic country with the US. For example Panama the first country to dollarize in 1904 experienced severe liquidity challenges between 1987 1989 as a result of the tension between the United States government and Panama.

Dollarization allowed Zimbabwe to quash hyperinflation (from 231 million % in June 2008 to 3% in June 2011), restore stability, increase budgetary discipline, re-establish monetary credibility and contribute to economic growth (Noko, 2011). However in spite of the benefits, empirical evidence suggests limitations of accessing capital (debt and equity) by SMEs in a dollarised economy. For example, Edwards and Magenzo (2006) found that volatility in accessing capital has been significantly higher in economies that dollarized when compared to non-dollarised economies. He also pointed out that dollarisation has a consistent and negative impact on financial deepening (the availability of funds provided by financial intermediaries to individuals, governments and firms. Evidence also suggests that the effects of dollarization differ depending on the degree of financial integration of the domestic country with the US**.**

In Zimbabwe, suffice to indicate that the ability of the country's fiscal and monetary policies to support SMEs remain a challenge on the back of limited fiscal space that was caused by multicurrency system. Zeparu (2017) pointed out that under the current multicurrency system the central bank has virtual lost control over money supply. For instance before dollarization the Reserve Bank of Zimbabwe used to extend loan facilities to SMEs through Commercial banks and Development banks such as Small Enterprises Development Corporation (SMEDCO). As at 31 December 2006, a total amount of $17, 4997 billion had been disbursed through 13 banks and 1 micro-finance institution to 367 borrowers as shown in table 1. The government through SMEDCO and with the support from the private sector and donor community used to extend substantial amounts of loan facilities to the SMEs sector. According to Kwesa (2009), however after dollarization the Central Bank ceased its role of lender of the last resort and this had a bearing on loans-to-deposits ratios which fell in the first 6 months of 2009 to 30 percent compared to 31 percent in 2008 and an average of 36 percent between 2003 and 2008. Kwesa (2009) also pointed out that interbank trading was limited to cash settlements. Again the low confidence levels in the financial sector (banks) resulted in the public keeping their foreign transactions outside the banking system.

Table 1: Disbursement by sector

Sector	Number of Borrowers	Amount ZWD ($00 000)
Manufacturing	188	838,53
Services	104	447,44
Engineering	15	90
Transport	14	98,70
Agriculture	31	200,26
Construction	6	28.62
Mining	3	12
Retailing	6	33,45
Total	**367**	**174997**

Source: RBZ Monetary Policy Statement December, 2006

Before dollarisation the Reserve Bank of Zimbabwe (RBZ) used to play a pivotal role as a lender of last resort in supporting SMEs through its Monetary Policy Statements. For example the RBZ Mid-Term Monetary Policy (2006) showed that the RBZ allocated a $16 billion Small to Medium Enterprises (SMEs) Revolving Fund facility following the announcement of its July 2006 Mid-Term Monetary Policy Statement as shown by Table 2. In order to ensure extensive disbursement of the facility, the RBZ engaged Micro Finance Institutions (MFIs) and the People’s Own Savings Bank (POSB) in addition to commercial banks and merchant banks. Out of the $16 billion, a total of $5 billion was set aside to support women entrepreneurs. While the commercial banks provided loans at concessionary rates to viable emerging business, RBZ would provide guarantees of 50% on outstanding amount in the event of default by the borrower. However under the current dollarized multicurrency system, the central bank has virtually lost control over money supply resulting in the facility being stopped and only being resumed in 2016 after the introduction of the bond note.

Table 2: Allocation of the $16 billion SMEs Fund

ALLOCATION	AMOUNT ZWD ($ billion)
Women	5
Youth	5
Other SMES	6
Total	16

Source: RBZ Mid-Term Monetary Policy Statement, July 2006

Since foreign banks were unwilling to extend lines of credit to countries with high risk levels such as Zimbabwe, this resulted in low foreign currency reserves for the country which in turn affected SMEs access to debt and equity capital. According Noko (2011), the Indigestion and Economic Empowerment Act of 2007 which required that black Zimbabweans own 51 percent of companies further acted as a deterrent for the country's financial integration with that of the global economy thereby inhibiting FDI. As highlighted in this research paper, low FDI also meant low debt and equity capital for SMEs.

A close look at the low level of financing to the SME sector can be attributed to the low level of financial inclusion. The FinScope Survey (2012) revealed that only 14% of SMEs were banked, only 18% were served by formal financial institutions, 39% were served informal financial services providers while 43% did not have access to financial services. Suffice to highlight again that the ability of the country's fiscal and monetary policies to support SMEs remain a challenge given the limited fiscal space under dollarized multicurrency system which have caused a lot of financial market distortions. Mangudya (2017) pointed out that data maintained by the central bank as at March 2017 reflected that only a total of $135,83 million credit was extended to the SME sector constituting a mere 3,78% of the entire banking sector loans and advances. This implies that that the majority of SMEs (86%) were not making use of any products or services from banks after dollarization.

Prior to the adoption of the multicurrency system, the Ministry of SMEs used to spearhead the disbursement of loans to SMEs through SMEDCO. Through the Small and Medium Enterprises Act, the Ministry of SMEs' objectives are premised on creating an economic and regulatory environment that promotes the growth and development SME. SMEDCO is a government owned local development finance institution established in terms of the Act to spearhead the development and growth of SMEs. SMEDCO maintains a fund known as the Micro, Small and Medium Enterprises Fund which consists of money that have been appropriated by parliament to the fund the financing of small and medium enterprises. The Fund administered by the SMEDCO board, apart from providing direct funding to SMEs also caters for wholesale finance to micro-finance institutions registered under the Zimbabwe Banking Act (Chapter 24:20).

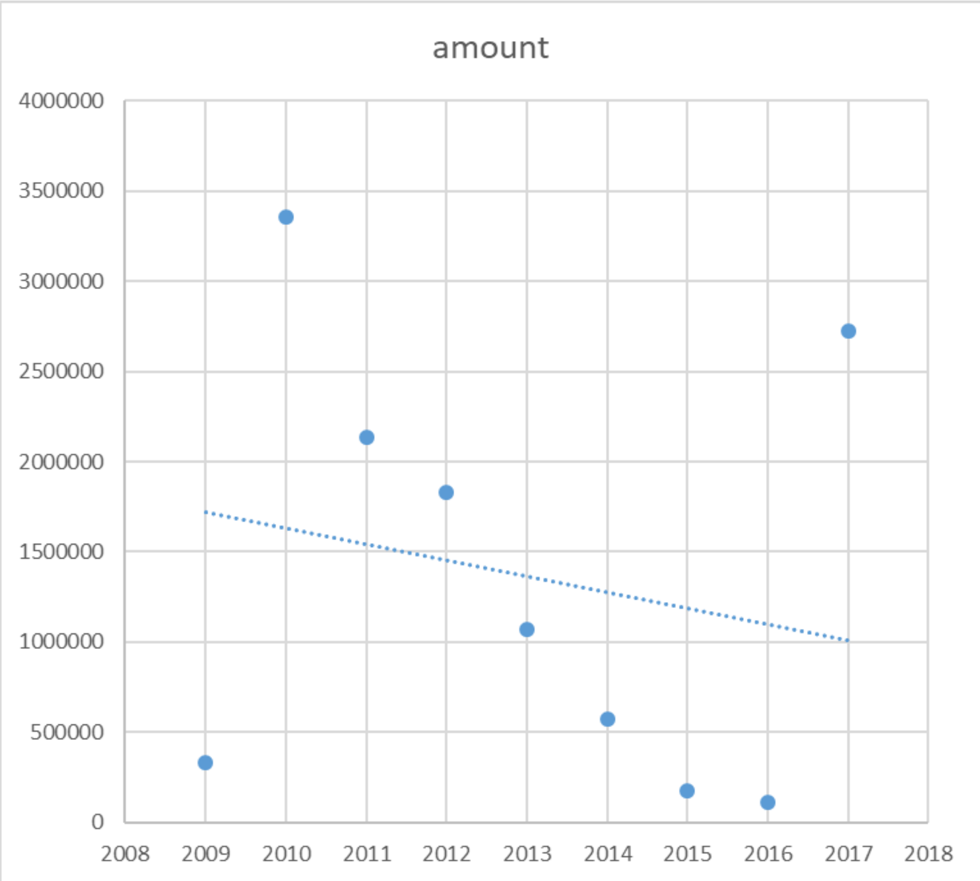
SMEDCO which had been spearheading the financing of SMEs prior to introduction of dollarisation multicurrency system started experiencing cash flow challenges after dollarisation resulting in the decline of loan disbursements to the sector as shown by table 3. An analysis of the data shows that there was a sharp downward trend in loan disbursements from the period 2010 to 2016 as depicted by the trend line in figure 2. Credit rationing emanating from liquidity challenges and information asymmetry in the financial credit market forced SMEDCO to reduce credit finance to SMEs sector.

Table 3: Loan disbursements by SMEDCO after dollarization

Year	**Amount ZWD$**
2009	331 349
2010	3 353 125
2011	2 138 246
2012	1 828 417
2013	1 068 450
2014	569 609
2015	172 683
2016	110 600
2017	2 725 090

Source: SMEDCO, 2017

Figure 2: Loan disbursements by SMEDCO after dollarization



Source: SMEDCO, 2017

In analysing the capabilities of SMEs in accessing finance after dollarization, it is essential to consider business acumen. Business acumen refers to the quickness and keenness in dealing with a business challenge in a way that is likely to bring efficiency of operations for the business (Railly and Railly 2009). In the context of SMEs, business acumen mainly focuses on the level of education and skills training, finance and business appreciation, access to formal financial services, business experience, and extent of business formalisation and use of marketing of appropriate marketing strategies. The FinScope Survey Report (2012) shows that the levels of education for SMEs are relatively good in Zimbabwe compared with other countries in the region. For instance only 31% of SME owners have primary education or less. The majority (73%) acquired the necessary business skills informally mostly through on the job training while 27% acquired the skills formally (through training programs, schools, college and university education).

While dollarisation multi-currency system has contributed immensely to the stabilisation of the Zimbabwean economy, it also brought about a number of challenges to SMEs especially after 2013 elections when the country started experiencing severe cash shortages and liquidity challenges which significantly affected SMEs capital structure needed for growth and development. Expanding access to financial services by SMEs is among the critical objectives of the RBZ inclusion agenda. However when it comes to financial inclusion, the FinScope Survey (2012) shows that the majority of SME owners did not have a bank account for business purposes which acted as a great impediment for them to save money and/or borrow from commercial banks. The same survey shows that only 3% had a separate business bank account in the name of the business. The lack of appropriate understanding of finance also had a bearing in choosing the appropriate and relevant SME financing model.

The adverse effects of dollarisation are that it will result in SMES in the country failing to access external finance hence relying mostly on their savings/retained earnings and other forms of income for their business growth and development. The FinScope Survey (2012) shows that only 9% of SMEs had ever received external business support besides the usual support received from internal networks such as family and friends. The same survey shows that of those that received business support from established corporates, 72% indicated that the support they received was helpful. Most of this support came from established organisations, that is 20% from corporates, while 13% from bank institutions. Non-governmental organisations (NGOs) also played a pivotal role (11% contribution). Interestingly only 5% of support was received from the Ministry of Small and Medium Enterprise and Cooperative Development (Finscope MSME Survey, 2012).

2.4 ALTERNATIVE FORMAL SOURCES OF CAPITAL

Whilst literature has pointed favourably to conventional forms of Equity (personal savings and retained profits) as the ideal source of capital for financing SMEs in a dollarized economy and during financial crises, there is need to look for the best alternative sources of equity capital for financing SMEs.

Venture capital (VC) as source of equity capital has been perceived as the panacea for SMEs growth and development by many countries around the globe. In fact the life of the venture capital industry has been ultimately dependent on success stories that have turned new bright ideas into profitable and scalable business ventures and backyard dreams into multimillion dollar operations (Pratt, 1986). Countries such as Malaysia, Singapore, Taiwan and Korea's VC presents good and appealing cases of the successful implementation of VC and good lessons can be learned for example on exit mechanisms for venture capital markets. The participation of IFC as an investor in venture capital operations in developing countries has also provided an excellent source of information for furthering the study.

VC has been an accepted as the generic term for Business Angels, Mezzanine Equity, institutional or other similar sources of financing in early stages of business. Thus VC is a professional management pool of equity capital. The financing model has been found to play a crucial role in the management of enterprises they fund since they work closely with the stock market to raise capital through public offerings (Saunders & Lim, 1989). Their core business is to support business start-ups through the provision of technical and managerial expertise as well as the granting of available exit strategies. It's important to highlight that whilst a lot of emphasis has been placed on SMEs as the engine of economic development, the ultimate goal in business should always be to ensure that SMEs transform and graduate into viable large enterprises. Research has shown that the current mega businesses and conglomerates in many Asian countries were once back-street small firms which grew over the years as their national economy and the world economy expanded (Pratt and Stanley, 1986).

Other studies have shown that the success of SMEs in the High Performing Asian Economies (HPAEs) is mainly as a result of effective business linkages between the SMEs and large established corporate (Pratt and Stanley, 1986). The Japanese economy presents a good example of a value chain process that embraced a strong vertical relationship (*kairetsu*) between SMEs and large corporates. Studies have shown that the majority of large corporates thriving in today's world once used Venture Capital to finance their operations when they were still in their infancy stage. FedEx is one such example that started with Venture Capital funding of only about USD70 in 1973 (Sagari and Guidotti, 1992). Thus in addition to choosing the right source of equity and debt capital, it is essential to also come up with bright ideas that can be exploited and turned into fully viable commercial enterprises.

The major benefit associated with VC is that SMEs can receive capital for start-up, expansion, development or bridge finance and initial public offering (IPO) at various stages during their growth processes right up to the exit stage. In Nigeria for instance, the results from research studies of the two categories of SMEs showed that VC financing has greater and more transformational effect on SMEs than debt financing (Umor and Agundu, 2009).

In Zimbabwe, the key question that needs to be addressed therefore is about alternative sources of equity capital for SMEs (apart from the traditional sources) that are needed to finance business operations in the dollarized multicurrency system. SMEs have little and insufficient cash flow to secure loans from financial institutions. Again due to the absence of quality information in the financial market, the level of capitalisation is very low for these SMEs since its costly to access external funding (Stiglitz and Weiss, 1981). According to (Pratt, 1986), the challenges encountered especially during the early stage of the firm create moral hazard problems that require to be managed by an outside investor (VCF) as they cannot adequately be dealt with through pure debt type of contracts. Thus the use of financial instruments that incorporates an equity element as opposed to debt is very crucial as it allows investors to access information and to share the responsibility and accountability for the business result. Again traditional sources of equity financing alone will not help in dealing with SMEs level of investments which normally takes the form of new and innovative ideas.

It is critical to highlight where privately-owned Venture Capital Firms (VFC) get their funds from so that policy makers, SMEs and investors can weigh the benefits of using VC as an effective alternative financing model for driving SMEs financing. VCF get the majority of their funding from pension funds. In the United States of America (USA) and Canada for example, pension funds are largest suppliers of capital for VCFs. In the USA, pension funds account for 53% of total new venture fund commitments in 1990 (Venture Capital Journal, 1991). In the United Kingdom in the same year they accounted for 25% of the total funds invested in independent venture capital firms. Foreign institutions and insurance companies are also amongst other large providers of funds for VCF in the UK.

In Japan, the Ministry of International Trade and Industry (MITI) established the Venture Enterprise Centre (VEC), a platform intended to help SMEs obtain technological autonomy, and to commercialise their research output. VEC also acts as a guarantor of the debt for SME firms it supports and as such its operations transcend pure venture capital operations. (Gotoh and Yoko, 1985)

A sound regulatory and legal framework is needed in order to establish successful and sustainable venture capital firms. To do this would require enacting laws that specifically relates Venture Capital operations. According to IFC (1986), countries like Korea and German have laws that specifically govern venture capital firms' operations. The existence of such a legal framework makes it easier to put in place relevant tax benefits for VCFs (Poterba and James, 1986) In the French legislation for example, there is a provision that sets thresholds for paid-in capital and there is a maximum ownership limit of 30 percent for any one shareholder amongst other rules. Other countries with specific Venture Capital legislation are Australia, Mexico, the Netherlands and Portugal (IFC, 1986). Having Laws that spell out the establishment and operation of VCFs is therefore important.

The challenge associated with VCF however relates to the entrepreneur's dilution of equity interest in the firm to the venture capital firm (VCF). Thus the enterprise will have to cede some control in terms of decision making as the VCF will seek to influence on major decisions like financing and investment. Abor (2011) pointed out that from the perspective of Pecking Order Theory, equity is more expensive than debt. Therefore the cost of venture capital funding is likely to be more expensive compared to bank debt.

2.5 IMPORTANCE OF SMES

The Zimbabwean economy is now largely driven by SMEs which have been regarded as the engine for economic growth and development. According to the current governor of the Reserve Bank of Zimbabwe (RBZ), the SMEs sector is playing a key role through poverty reduction and employment creation and contributes more that 60% of the country's GDP and are responsible for the livelihood of 80% of the population (Mangudya, 2017). He also pointed out that in terms of employment, Zimbabwe's SMEs employ around 5,7 million people thereby representing a total workforce of about 73% of the total workforce of 7,8 million in Zimbabwe. However, the same official admits that SMEs in Zimbabwe still lag behind in terms of financial inclusion.

The decline in employment levels within the formal sector since year 2000 due to company closures and retrenchments attributed to low capacity utilization has resulted in the SME sector assuming greater prominence as a source of livelihoods for many families in the country. It is critical to harness and optimize the potential of SMEs through a robust financing framework that encourages their growth and development. Provision of foreign loans is critical to lower high interest rates that have been hovering around an average of 20 percent after dollarization. The high interest rates have mainly been as a result of reluctance by foreign banks to extend loans to local banks and this resulted in unmet demand for credit for the SMEs sector. The argument about the reluctance of foreign banks to extend lines of credit to Zimbabwe has been centered on country risk and the desire by foreign banks to protect shareholders value through risk mitigation measures to countries perceived to be high risk (Berg and Borensztein 2000).

Earlier studies have also shown that when a country dollarizes, banks start to ration loans especially to the SMEs. For example Modigliani and Miller (Stiglitz and Weiss, 1981) attributed this to information asymmetries which give rise to more financial contracting of the SME sector and agency costs which can negatively influence the riskiness and size framework of a firm's capacity to generate cash flows. Since most forms of external finance appear expensive, the Majluf and Myers (1984) theories argue that with the perking order model internal cash flows (retained earnings) are the preferred source of financing new investments. Research has also shown that external suppliers of debt finance are unwilling to finance risky investments like SMEs, if they cannot to raise interest rates sufficiently without facing severe adverse selection challenges (Stiglitz and Weiss, 1981). Thus, financial perking order can also be as a result of external debt finance being subject to rationing and other capital constraints. Thus according to the pecking order theory when SMEs are in need of additional finance, retained earnings will be preferred over debt that debt will be preferred over issuance of shares to new investors.

Using the right source of capital in dollarized multicurrency system is critical in helping SMEs in crafting relevant and appropriate investment decisions for their enterprises. Many studies and business surveys have identified access to finance as the most essential factor in determining the development, growth and survival of SMEs (Beck and Demirguc-Kunt, 2006). In Zimbabwe due to liquidity challenges that the country has been going through, long-term deposits have since declined and banks have to contend with just short term and transitory deposits. Also the continued meltdown of the Zimbabwean economy as a result of the multicurrency system in 2009 and the introduction of the bond note in 2016 affected banks' ability to underwrite loans to the SME sector. Whilst the government established 'Zimbabwe Agenda for Sustainable Social and Economic Transformation' (ZIMASSET) in 2013 anchored to a larger extent on the growth of SMEs (Tinarwo, 2016), its role in supporting SMEs was equally affected by the constrained fiscal space after dollarization.

2.6 THEORETICAL FRAMEWORK

For this particular research study, the theoretical framework focused on the demand side data set of the Pecking Order Theory in providing an analysis of the ideal source of capital for SMEs in a dollarized multicurrency system using SMEs as the primary unit of analysis. The supply side of the Credit Rationing Model was also used to complement the analysis using bankers and officials of purposively sample institutions that have been financing and capacitating SMEs as the secondary unit of analysis.

2.6.1 THE CREDIT RATIONING THEORY

In Zimbabwe specifically after dollarization and adoption of the multicurrency system, the supply of credit to SMEs drastically reduced as banks started rationing credit to the sector. Distortions in the exchange rates and financial credit market brought about by the multicurrency system and the introduction of the bond note made it extremely difficult for banks to extend loan facilities to the sector. Stiglitz and Weiss Model (1981) pointed out that credit rationing is as a result of a mismatch between demand and supply of credit mainly caused by information asymmetry between the borrower and lender. The data maintained by the RBZ shows that as at 31 March 2017, only a total of $135, 83 million credit was extended to the SME and this figure represents a mere 3,78% of the entire banking sector loans and advances (Mangudya,2017).The shortage of foreign currency which resulted in cash shortages and the introduction of the bond note caused severe market distortions which forced banks to reduce credit to SMEs. The absence of credit registry, collateral registry and credit guarantee scheme has contributed immensely to credit rationing specifically to the SMEs which is considered to be a risk sector.

SMEs have information relating to their financial structure, viability of projects and capacity to service the debts which the banks themselves do not have. Stiglitz and Weiss (1981) argues that credit rationing to SMEs is mostly as a result of agency problem and information asymmetry. In view of this, banks will act to reduce the level of risk exposure through rejection of applications for credit or through rationing the value to the sector during periods of financial crises. Again there are also chances that a borrower can misappropriate borrowed funds by undertaking activities that are not in line with the purpose of the loan. In this case adverse selection can change the lender's beliefs and cost of funds hence leading to credit rationing. Zambaildi, Aranha, Lopes and Polit (2009) pointed out that adverse selection and moral hazard are inversely related to the size of the firm and age such that credit rationing is prevalent to SMEs than large firms.

In Zimbabwe due to ineffective financial infrastructure systems after dollarisation, the banking sector ended up undertaking credit rationing to the SME sector and this resulted in a considerable increase of unmet demand for capital. The low volume of credit in the country cannot entirely be attributed to resources constraints in the banking institution but rather to financial market distortions caused by the multicurrency system. Due to distortions in the financial and credit market in Zimbabwe caused by the introduction of the bond note and convertibility of Real Gross Settlements (RTGs) balances, banks have faced difficulties in figuring out which SMEs are creditworthy due to exchange rate and credit market distortions. Studies have also shown that banks in developing economies lend only a small portion of total deposits that they mobilise.

Specifically after the adoption of a multicurrency system, banks needed reliable information for them to make sound and informed decisions about the credit worthiness of SMEs before they could extend loans to the sector. However information asymmetry made it difficult to make these decisions in Zimbabwe. According to Abor and Biekpe (2006), the success probability of a project is better known by the borrower than by the bank due to information asymmetry. This also implies that when borrowers access loans, they will rather opt to shift from safe projects with normal returns to high risk high return projects that have low probability of success. Thus imperfection in the SME credit market emanating from perceived high risk due to perceived high probability of failure of SME projects after dollarization resulted in drastic reduction of credit to the sector.

It's also critical to point out that in Zimbabwe credit rationing to the SMEs cannot just be attributed to financial repression policies such as credit/interest rate ceilings but rather to resource availability in the banking sector as a result of dollarization. Again after the introduction the multi-currency system, it was very difficult for investors and lenders to place a value on SMEs businesses. In his seminal paper titled, "The market for lemons", Akerlof (1970) makes a major contribution to the theory of asymmetry information. He suggested that in funding development projects, if investors cannot figure out the value of a business, then they will be left with no choice but to reduce the level of investment in those firms. Thus lack of equal access to information between two parties engaged in a transaction results in information asymmetry.

The World Bank (2015a) reports that Zimbabwe's financial sector has been subjected to severe distress after the adoption of a multicurrency system in 2009. In their research paper

Sachikonye and Sibanda (2016) argued that the operating environment has resulted in the shrinking of the financial services sector, a scenario that affected the level of SME financing by banks. The point is that credit risk is a significant concern for banks and as a result they are reluctant to lend to SMEs (World Bank, 2015b). This phenomenon of credit rationing has mostly affected SMEs than large corporates (Duan, Han and Yang, 2009). It is again critical to point out that whilst the country adopted a multicurrency system, international and regional lines of credit remained subdued (Malaba, 2014), a phenomenon the affected the provision of credit to the SME sector by banks.

SMEs have faced challenges in accessing loans from the banks and this was worsened by the introduction of the multicurrency system. The market imperfectness makes it difficult for banks to obtain accurate information about borrowers and information on how to monitor their actions. For instance, Stiglitz and Weiss (1981) argues that information asymmetry and controlling of interest rates would automatically change the behaviour of banks who in turn would start to ration credit through non price mechanisms. The model is based on imperfect credit markets where interest rates are not controlled and markets are characterised by information asymmetry. The theory is premised on the assumption that the objective of banks is to maximise profits through the prudent supply of credit and the use of collateral to reduce default rates.

The low level of the credit market in Zimbabwe after dollarisation has been found to be a great impediment to SME financing. In line with Ocran's (2012) arguments, lenders in developing countries are saddled with high transaction costs for lending to the SME sector in times of financial crisis due to information asymmetry. The author further pointed out that the absence of important financial sector infrastructure such as public and/or private credit registries/ bureaux contributes to high level of information asymmetry and the associated problems of adverse selection and moral hazard which in turn tends increase transaction costs of lenders.

Research has shown that financial markets in Africa are characterised by a lot of market imperfections emanating from decisional problems such as moral hazards and adverse selection. The problems have been found to be more prevalent in the SMEs financial market where there is high risk, high transaction cost and uncertainty among other factors (Kimuyu and Omiti, 2000). Although financial institutions in developing countries are believed to have a wide range of financial facilities including long term loans, they still have restricted financial access to SME mainly due to perception of risks and high transaction costs of delivery (Beck and Demirguc-Kunt, 2006). In spite of the interventions from micro-finance institutions (MFIs) and banks, the majority of SMEs in the country particularly at the start-up phase are still severely constrained.

It is a global norm that in financial crises large corporates with credit capacity are given preference by banks than SMEs as they appear to be more resistant to market stresses such as asymmetric information, adverse selection and moral hazard. Thus the efficient and effective credit management policies by banks incorporate credit rationing to the SME due to the riskiness of the sector (Kundid and Ercegovac 2011). The absence of collateral security, rising interest rates and uncertainty augment the probability of credit rationing to the SME seemed to have affected the sector more after dollarization multicurrency system.

In spite of the support from the government and local development finance institutions (DFIs), SMEs in the country have been finding it difficult to access finance from banks especially after the introduction of the multicurrency system. This was mainly due to SMEs' lack of the required collateral security which compelled banks to practice credit rationing to this highly perceived risky sector (Gangata, 2013). This line of thought was confirmed by Manyani (2014) and Nyanga (2013), who argued that SMEs in the country face a number of critical challenges as they strive to develop into fully fletched enterprises and to graduate into the mainstay economy. These critical challenges include amongst others limited access to credit finance and unavailability of supporting information (use information asymmetry and credit registry).

The high level of unmet demand for credit by banks to the SME sector can be attributed to credit rationing. The FinScope (2012) survey data shows that between 2011 and 2012 only a total of 15% of SMEs managed to borrow money for business purposes or were repaying or owing money/goods for their business. Again interestingly the 15% when disaggregated shows that only 2% of SMEs borrow from the bank and whilst the other 2% borrow from other formal non-bank financial institutions. On the other hand, 3% borrow from informal groups and 8% borrow from family and friends as shown in table 4. Thus the data shows that the greatest percentage (8% out of 15%) of SMEs debt was coming from family and friends.

Table 4: Percentage of SMEs who managed to get loans from banks

Banked %	Other formal %	Informal %	Family and friends %	Excluded %
2	2	3	8	85

Source: FinScope Survey, (2012)

2.6.2 THE PECKING ORDER THEORY

For the SMEs in Zimbabwe, the question is whether to consider outside or inside finance and again whether the ideal source should be debt or equity capital. The Pecking order theory was espoused by Myers and Majluf (1984) is based on the fact that inside management of an enterprise are better placed and in a position to ascertain the true value of the firm than outsiders. The pecking order argues that firms of various sizes select their financial structure taking into cognisant their cost, nature and financial options availability. In line with the pecking order theory, firms prefer sources of capital that are least susceptible to undervaluation. Thus firms usually prefer internal sources (personal savings and retained profits) over other financial sources.

Earlier studies have also shown that when a country dollarizes, banks start to ration loans especially to the SMEs. Stiglitz and Weissi (1981), attributed this to information asymmetries which give rise to more financial contracting of the SME sector and agency costs which have the potential to negatively influence the riskiness and size framework of a company’s future cash flows. Since most forms of external finance appear expensive, the Myers and Majluf (1984) model confirm that with the Perking Order Model internal cash flows (retained earnings) are the preferred forms of financing new investments. Research has also substantiated findings by arguing that external suppliers of debt finance are unwilling to finance risky investments like SMEs, if they are unable to raise interest rates sufficiently without encountering severe adverse selection challenges (Stieglitz and Weiss, 1981). Thus the Perking Order may also arise due to external debt finance being subject to rationing and other supply constraints. Thus according to the Pecking Order Model when SMEs require additional finance, the use of retained earnings will be preferred over debt and that debt will be preferred over new shares to outsiders.

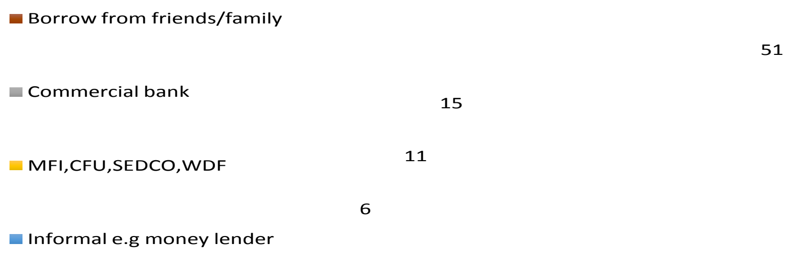
The Perking Oder Theory is an important model that SMEs can use in developing countries to identify relevant and optimal sources of capital for their enterprises. This is because in developing countries unlike in developed countries where credit markets perform well, the opposite is true for developing countries. For example it is estimated that in USA about 50,4 % of SMEs financing comes from debt whilst 49,6% comes from equity (Berger and Udell 1998). The opposite is however true in developing countries where credit is heavily rationed especially to risk sectors such as SMEs. In fact in developing countries the largest source of capital (about 35%) for SMEs comes from the owner himself/herself (Berger and Udell 1998). The sources of debt include mostly trade credit, finance institutions and government development institutions while equity capital comprise mainly of wealthy individuals (business Angels), individual investors and syndicates of investors such as venture capital.

In their regression model looking at the relationship between the determinants and the bank-debt ratio, Kundid and Ercegovac (2011) reported that in Croatia bank loans account for less than a quarter of SMEs total debt financing and the results reveal that age and size of the firm along with asset tangibility have a significant positive correlation with the bank-debt ratio. Whilst there is the significant realisation of encouraging SMEs to thrive (Fisher and Reuber, 2000) due to their importance to economic development, SMEs have faced difficulties in accessing finance. Biekpe (2004) pointed out that most SMEs particularly in Sub-Saharan Africa fail in their first year of operation due lack of support from the traditional banks and the government.

When internally generated cash flows are not sufficient to sustain the required rate of investment and business growth, firms would then be forced to look for external sources of finance. In line with the pecking order, firms prefer to use debt first followed by hybrid securities and finally resorting to equity. In Zimbabwe banks play a critical role in SMEs financing. In a nut shell the pecking order theory attempts to explain that businesses tend to follow a hierarchy when it comes to utilisation of financial sources, such that when internal sources are insufficient, external finance is then considered with debt being preferred over equity.

The perking order (ranking of all external sources of finance) theory demonstrates that in the absence of cost-effective risk assessment, monitoring and intervention technology, external suppliers of debt finance may also be reluctant to finance some form of risky investments like SMEs if they are unable to raise interest rates sufficiently enough without encountering adverse selection' problems (Stiglitz and Weiss, 1981). Thus according to the Pecking Order theory when SMEs are in need of additional funds, retained earnings will be preferred over debt and that debt will be preferred over new share issues to outsiders. Debt will normally be preferable to issuing new equity to external investors since the latter will be costly and will lead to a dilution of ownership. The Pecking Order also ranks debt sources of finance by decomposing it into various components such as hire purchase liabilities, long term debt, short term debt (including overdrafts) and intra-group debt balances. The FinScope MSME Survey (2012) asserts well the position and relevance of the Perking order in financing SMEs. For example of the SMEs (15%) who finance their businesses through borrowings, about 51% of them borrow from family relatives and friends. The survey data shows that only a quarter (15%) borrow from the banks, with only 6% getting their debt capital from informal mechanisms such as money lenders. Figure 2 below refers.

Figure 3



Source: FinScope Survey (2012)

Various theories such as Jordan et al. (1998) focus on the determinants of optimal capital structure by making the assumption that there are only two types of sources of finance, namely equity and debt. SMEs capital structure models, such as Myers (1984), focus on information asymmetries between insiders (managers, who are assumed to always act in current shareholder interests) and outsiders that is potential new debt and equity suppliers.

Avery et al. (1998) also supported the notion by Berger and Udell (1998) by highlighting that the entrepreneurs need to have significant personal wealth (net worthy) that can be used as collateral for securing debt finance. The opposite is true in developed markets where households, SMEs and firms can easily access loans at a reasonable cost and at the same time there are various credit facilities offered by both banking and non-banking financial institutions. In contrast research has shown that the formal credit market in developing economies is characterised by a number of challenges. For example the lack of important financial infrastructure like Public/private registries tend to increase transaction costs which in turn cause credit rationing.

By weighing all external sources of finance (debt and equity) that includes new issues of shares and that appear excessively expensive, the Myers (1984) and Myers and Majluf

Theory (1984) theory demonstrate the existence of a perking order whereby internal cash flows (retained earnings) are the preferred form of financing for new investments. The authors argued that in the absence of cost effective risk assessment, monitoring and intervention technology, external suppliers of debt finance may be reluctant to finance some form of risky investments such as SMEs if they are unable to raise interest rates sufficiently to reach an equilibrium without encountering serious adverse selection problems (Stieglitz and Weiss, 1981). Stieglitz and Weiss (1981) also pointed out that the Perking Order Model may also arise due to external debt finance being subject to rationing and other supply constraints. This means that in practice the interaction of owner manager and external supplier's preferences can be expected to produce firm level financial structure decisions consistent with "perking order" whereby internally generated sources of finance will be preferred over external sources. The Perking order results also suggest that Perking order is also extended to debt types of finance especially when the debt capital is decomposed into its various elements (Watson and Wilson, 2002).

Winborg and Landstrom (2000) argued that considering other alternative sources of finance other than just the conventional sources (equity and debt) is essential for SMEs growth and transformation. The alternative forms of capital are called bootstrap financing. Bootstrap financing can be defined as the use of alternative sources of financing instead of just relying on long term external finance. Bootstrap financing has been considered as an alternative and cost effective source of capital for SMEs that overcomes the perceived risk associated with the conventional sources.

Financing decisions are among the most important and challenging decisions faced by SMEs. The issue however has always been the need to overcome the bottlenecks in an effort to access capital especially outside capital (Mason and Harrison, 2002). Inappropriate sources of capital, shoe string budgets and lack of information about capital acquisition have always affected a firm as it strives to adequately finance its operations and pursue market opportunities. Inappropriate financing decisions have been commonly considered to be the major contributor to SMEs failure (Coleman, 200 and Kuratko and Hodgetts, 2001). The capital structure theory highlights that SMEs should strive to acquire capital in a way that blends the wealth of the entrepreneur through overall cost minimisation strategy attained through optimal levels of equity and debt capital (Myers 1984). High agency costs that emanate mostly from bonding and residual loss , monitoring, not having access to segments of the financial markets and lack of information about financing alternatives are the bottlenecks that have been confronting SMEs in their search for appropriate and relevant sources of capital(Gibson and Landstrom, 1992 and Van Auken 2000.

CHAPTER 3: METHODOLOGY

3.1 Research Approach

The research study used quantitative research approach to draw meaning from data collected in numerical and standard form and analysed statiscally. The research study sought to come up with a theory that could be generalised in its application to SMEs financing in a dollarized multicurrency system hence the choice of a quantitative research method. The approach began by looking at theories that already existed, followed by hypothesis development.

3.2 Research Design

This research study used survey research to collect data from interviews conducted with both formal and informal SMEs based at Gazaland Home Industry and in addition also managed to collect data from officials such as capacity builders, officers and trainers of local SME Development Finance Institutions (DFIs), Ministry of Small and Medium Enterprises, Banks (including Central bank), Support organisations and NGOs that have been involved in the financing and capacity building of SMEs. Gazaland Home Industry houses a wide range of businesses and industries ranging from automotive, production, furniture making, manufacturing, welding and fabrication, banking, transportation, fuel and retailing among many others. The SMEs interviews were facilitated by a Ministry official who managed to explain to the respondents the objective and importance of the research study. Before commencing interviews, the researcher would each time welcome participants by thanking them for volunteering to participate in the survey. The researcher went further to explain the purpose of the research survey to the respondents before conducting interviews with the various business operators. Using the Social Statiscal Packages for Social Sciences (SPSS) and Content analysis, the findings from the interviews were analysed quantitatively and qualitatively.

The survey method was preferred to other data collection methods because financial institutions in the country did not maintain disaggregated data pertaining to SME financing and sufficient to cover the study period. Again for this particular research, individuals served as key informants and therefore unit of analysis in this regard. The objective basically was to collect relevant and appropriate data within the given timeframe and with the highest response rate.

3.3 Population and Sampling Procedures

Population

The study population consisted of SMEs based at Gazaland Home Industry in Highfield Harare and officials of key institutions that have been involved in financing and capacity building of SMEs such as bankers, capacity builders, officers and trainers. Gazaland Home Industry is an SME hub in Harare that houses a wide range of businesses and industries ranging from automotive, production, furniture manufacturing, welding and fabrication, banking, transportation, fuel and retailing among many other businesses

Sampling

Within the context of the broadly defined population, the sampling procedure that was used for this research study was non-probability sampling rather than probability sampling technique. The researcher conducted interviews with both formal and informal SMEs based at Gazaland Home Industry in Highfield, Harare to gain an insight about how dollarization multicurrency system has been affecting SMEs financing in Zimbabwe and to come up with an the ideal source of financing that can be used by SMEs in times of financial crisis such as the current multicurrency system. The interview process at Gazaland Home Industry was facilitated by the meetings that were held between the government Ministry official and SMEs which sought to clarify and explain the objective of the research study. In addition to SMEs interviews held at Gazaland Home Industry, the researcher conducted interviews with officials (bankers, trainers, capacity builders) of purposively sampled institutions based in Harare that have been involved in financing and/or capacity building of these SMES. This was done in order to enhance interpretation of results. These key institutions included Small and Medium Enterprises Development Corporation (SMEDO), Reserve Bank of Zimbabwe, Ministry of SMEs, Zimbabwe Youth Council, Commercial Bank of Zimbabwe (CBZ), Small and Medium Enterprises Association of Zimbabwe (SMEAZ), Zimbabwe National Chamber of Commerce (ZNCC), Confederation of Zimbabwe Industries (CZI) and Indigenous Business Women Organisation (IBWO).

The use non-probability method (Gazaland SMEs and officials of key institutions) was preferred to random sampling for reasons of practicality and convenience. The use of key institutions such as banks (including the central bank) was also deemed appropriate since the officials of these banks have been involved in the financing and training of SMEs In this study, there was no intention of manipulating or controlling variables. The choice was also based on the background of the prevailing market and exchange rate distortions which have created parallel market for foreign currency trading thereby making any survey concerning dollarization being perceived as a scheme meant to make SMEs accountable for forex generated.

3.4 Data Collection

There are two main sources of data that is primary and secondary sources. The researcher adopted a two pronged survey method to gain insights into the study using two semi-structured questionnaires as the main data collection instruments as illustrated below.

The first survey focused on the demand side of SME financing by interviewing SMEs based at Gazaland Home Industry in Highfield, Harare. Sixty questionnaires in this regard were hand delivered to SMEs who had volunteered to partake in the research survey. As alluded earlier on in this document, the interviews were made possible following meetings that were held by the SMEs with a government ministry official. Before commencing interviews, the researcher would welcome respondents and thank them for volunteering to participate in the study. The researcher explained the purpose of the research study to the respondents and went further to clarify certain questions during the course of interviews.

The second survey which mostly focused on the supply side of SME financing in answering research questions involved the hand delivery of sixty semi-structured questionnaires to bankers and officials of key institutions that have been involved in the capacity building and/or financing of SMEs. These institutions included SMEDCO, Ministry of SMEs, Empretec, and Reserve Bank of Zimbabwe, Small and Medium Enterprises Association of Zimbabwe (SMEAZ), Commercial Bank of Zimbabwe (SMEAZ), Zimbabwe Youth Council, Zimbabwe National Chamber of Commerce (ZNCC), Confederation of Zimbabwe Industries (CZI) and Indigenous Business Women Organisation (IBWO). Apart from being conveniently available, these officials were also deemed knowledgeable to provide the researcher with reliable data and information for use in this research study.

3.5 Data Analysis

The study adopted a two-level unit of analysis. The primary unit of analysis were the individual SMEs based at Gazaland Home Industry in Highfield while the secondary unit of analysis involved officers, bankers and capacity builders of key institutions that have been financing and/or capacitating SMEs. The primary unit of analysis sought to answer the demand side of the data set whilst the secondary unit looked mostly at the supply side of the data set. Statiscal Package for Social Sciences (SPSS) and Excel software were used to perform all the data analysis on the relationships between dollarization multicurrency system and SME financing. The analysis was deemed critical finding out how dollarization multicurrency system affects SMEs financing and also in coming up with an ideal source of financing in periods of financial crisis such as the current multicurrency system.

3.6 Research Limitations

The greatest hurdle encountered related to reluctance by some of the institutions especially banks to partake in the research survey as they classified all financial information as confidential in their operations in spite of the fact that the researcher had included a special clause in the questionnaire indicating that all information gathered from the survey would be kept confidential and that it would only be used for academic purposes. Only 3 financial institutions agreed to take part in this survey that is one development bank, one commercial bank and the central bank.

3.7 Research Ethics and Data Credibility

In conducting this study, observance of ethical guidelines was taken into account since the survey involved humans as research participants. The whole objective of ethics in research study was to ensure that no one was harmed or suffered adverse consequences as a result of the study or output thereof (Saunders, et, al, 2009). The study was guided by honesty and integrity to protect the rights of participants. Ethical issues with regard to self-determination, anonymity and confidentiality were observed throughout the research process. In this research study the researcher undertook to protect the rights of the respondents by ensuring that none of them was injured or harmed during the course of the research study and subsequent research output. Therefore as far as possible the study was carried out in full honesty and full avoidance of deception in line with University of Cape Town (UCT) code of ethics.

CHAPTER 4: FINDINGS AND DISCUSSION

This chapter presents the research findings following interviews conducted by the researcher with SMEs based at Gazaland Home Industry in Highfield Harare and also following a purposive sample of selected bankers, capacity builders, officers and trainers of key institutions that have been involved in financing and capacity/building of SMEs. The overarching research objective was premised on investigating the ideal source of financing (debt or equity) for SMEs in a dollarized multicurrency system. In carrying out the survey the researcher noted that both the Ministry of SMEs and the Reserve Bank of Zimbabwe did not have disaggregated data pertaining to the research problem (SME financing). Instead they relied mostly on data from FinScope (2012) MSME Survey. Only SMEDCO had the relevant secondary data for use in this particular research study.

4.1 DESCRIPTIVE

For the 60 questionnaires that were distributed for interviews with SMEs based at Gazaland Home Industry, all of them were successfully completed and deemed usable for this research analysis. For the 60 questionnaires that were sent out to officers of purposively sampled institutions, 53 of them were successfully completed and deemed usable for the research analysis. This represents a 94% response rate which can be considered high enough to ensure validity and reliability of research findings. Saunders et al (2009) pointed out that high response rates increase validity of research findings.

4.1.1 **PRIMARY UNIT OF ANALYSIS**

- **Ideal source of capital for SMEs financing**

The respondents asserted to the fact that accessing finance during the multicurrency system was a significant challenge for SMEs due to the barriers they have been facing in accessing external financing such as high demand for collateral security and stringent credit rationing policies by financial institutions. Whilst SMEs have always relied on their personal savings for their business financing, the survey showed that a total of 33,3% and 63,3% respondents used bank loan and own savings respectively to finance their business operations before dollarization as highlighted by Table 5. In comparison to pre-dollarisation era, the survey showed that the level of credit to the SMEs declined significantly after dollarisation and the adoption of the multicurrency system as evidenced by table 6 illustrating that a total of 91,7% of SMEs wholly relied on their own personal savings to finance their business operations with only 1,7% managing to supplement their financing with additional loans from MFIs and Homelink. Those respondents who managed to get loan facilities had significant net worthy that they used as collateral to secure debt finance.

Table 5: Main sources of capital for SMEs business before dollarization

	Frequency	**Percentage**
Own savings	38	63.3
Business finance	2	3.3
Bank loan	20	33.3

Table 6: Main sources of capital for SME business after dollarization

	Frequency	**Percentage**
Own savings	55	91.7
Business finance	4	6.7
Bank loan	1	1.7

In line with the Pecking Order theory, the respondents have been selecting their financial structure on the basis of costs and limited options available. Given the level of crisis that have been bedevilling the financial market in particular and the economy at large, 90% of the respondents recommended equity as the ideal source of finance under a dollarised environment as shown by table 7. The same table shows that only 8,3% of the respondents recommended for the use of both equity and debt capital whilst only 1,7% recommended for debt capital. Thus from a Pecking Order perspective, when the respondents wanted additional funds, retained earnings were preferred over debt and that debt was preferred over new share issues to outsiders.

Table 7: Ideal source of capital in a dollarized environment

	Frequency	**Percentage**
Debt	1	1.7
Equity	54	90.0
Equity and Debt	5	8.3

- **Effects of dollarization on SMEs financing.**

The respondents asserted to the fact that they could access funding from financial institutions before dollarization since the government through the Reserve Bank of Zimbabwe (RBZ) used to unveil loan facilities to the SMEs sector via SMEDCO. The respondents indicated that the RBZ used to play a pivotal role in supporting SMEs through its monetary policy statements. According to the respondents, the table turned when the RBZ ceased its central bank role and the situation even deteriorated after the introduction of the bond note which caused a lot of distortions in the financial market as asserted by 98,1% of the respondents as shown by Table 8.

Table 8: Cessation of RBZ as the lender of last resort

	Frequency	**Percentage**
True	52	98.1
False	1	1.9

The survey as reported by 98,3% showed that respondents cited accessing finance (both equity and debt) as the main obstacle under a dollarized multicurrency system as illustrated by Table 9. The respondents attributed their challenges in accessing finance mainly to cash shortages and crisis in the financial market which was worsened by the introduction of the bond note. According to the respondents, the introduction of the bond note in 2016 resulted in the re-emergence of the parallel market. As shown in Tables 10 and 11, the majority 98, 3% of the respondents indicated that it became more difficult for them to obtain bank loans after dollarization multicurrency system due to high demand for collateral security (as reported by 96,7%) and stringent credit rationing policies that were being practiced by the banks, low savings and cash shortages that was being experienced by the financial services sector.

Table 9: Main obstacle for SMEs after dollarisation

	Frequency	**Percentage**
Lack of finance	59	98.3
Lack of entrepreneurial skills	1	1.7

Table 10: Ease of accessing capital after dollarisation

	Frequency	**Percentage**
Ease	1	1.7
Difficult	59	98.3

Table 11: Banks requirements for accessing loans under the multicurrency system

	Frequency	Percentage
Collateral	58	96.7
Business plan	2	3.3

Whilst 98,3% of the respondents cited lack of finance as the main obstacle for their business growth after dollarization, the survey showed that 95% could not access banks loans during the multicurrency system as shown by tables 12 and 13. The 5% respondents who had managed to access bank loans during the period under review indicated to the researcher that the loans were small amounts meant for their working capital requirements and obtained from Homelink (a subsidiary of the Reserve Bank) and some MFIs in 2016 when the bond note was introduced. Also worth noting is the fact that the 5% who had received small amounts of loans for their working capital requirements from Homelink indicated to this researcher that they had not received any form of loans from banks during the period 2009 to 2015 and as such were relying on their own personal savings. The lack of collateral and inadequate business cash flows to use as security made it extremely difficult for them to access the much needed loan capital. The respondents all indicated that in the absence of collateral security, they were required to pay exorbitant interest rates on formal bank loans ranging from 18% to 30% regardless of the bankability of their business proposals.

Table 12: Challenge in accessing capital under dollarization multicurrency system

	Frequency	Percentage
Failing to get investors	3	5.0
Failure to get bank loans	57	95.0

From a Pecking Order perspective, the indications from the study are that there were limited options for accessing finance from a conventional source by SMEs. Those firms that managed to survive to this date only did so on account of their ability to mobilize internal savings and equity injections as illustrated by Table 13. The reason for applying the Pecking Order Model has been to avoid high agency costs associated with debt finance and the fear of losing control after taking external finance. The study showed that in line with the Pecking Order Model, SMEs selected their financing structure based on costs, nature and available financing options. The SMEs in this regard preferred internal sources (personal savings and retained profits) over external financing options.

Table 13: SMEs sources of capital under the dollarization multicurrency system

	Frequency	**Percentage**
Internal Finance only	57	95.0
Internal and External	3	5.0

When asked by the researcher to confirm whether banks increased rationing to sector after dollarisation, the majority (as indicated in Table 14) of the respondents as indicated by 96,7% (65% and 31,7% for agree and strongly agree respectively) indicated that indeed the level of credit rationing by banks increased after dollarisation. Only 3,4% doubted and as such did not agree with this assertion.

Table 14: Credit Rationing

	Frequency	**Percentage**
Strongly disagree	1	1.7
Disagree	1	1.7
Agree	39	65.0
Strongly agree	19	31.7

- **Alternative sources of capital for SMEs financing.**

When asked by the researcher about the possibility of entering into partnership arrangements to enhance their capital base during this financial crisis period, the respondents (70%)

expressed resentment to the idea for fear of dilution of business ownership as shown in Table 15. Despite the high level of resistance to the idea that was mooted, the respondents however indicated that in order to ameliorate the financing challenges they had been facing under the multicurrency system, they would rather prefer (as reported 70%) an institutional investor as opposed to an individual investor as shown by Table 16. The rationale behind their choices were based on perceived sound corporate governance practices normally associated with institutional investors.

Table 15: Partnership and Collaborative Arrangements

	Frequency	**Percentage**
Yes	42	70.0
No	18	30.0

Table 16: Preferred Partnership and Collaborative Arrangements

	Frequency	**Percentage**
Individual	18	30.0
Company	42	70.0

4.1.2 SECONDARY UNIT OF ANALYSIS

The researcher collected data from officials such as bankers, trainers and capacity builders of purposively sampled institutions such as banks (including the central bank), Local Development Financial Institutions, Ministry of SMEs, Support Organisations and NGOs that have been involved in the financing and capacity building of SMEs using a semi-structured questionnaire.

- **Ideal source of capital for SMEs financing**

From a Credit Rationing Model perspective, the absence of external lines of credit affected the provision of credit to the SME sector by banks. As reported by the majority of respondents (84,9%) from the sampled institutions in Table 17, the ideal source of capital in a dollarized economy multicurrency system should be equity. The respondents that included bankers and capacity builders who have been involved in the financing and capacity building of SMEs asserted to the fact that after adoption of the multicurrency system, the supply of credit to SMEs was drastically reduced. They attributed the low level of credit to SMEs to the liquidity challenges that banks have been facing. Only a total of 15,1% advocated for the use of debt finance as shown in table 17.

Table 17: Ideal source of capital for SMEs under multicurrency system

	Frequency	**Percentage**
Debt	8	15.1
Equity	45	84.9

- **How dollarization affected SMEs Financing**

In line with the Credit Rationing Model the respondents indicated that foreign currency and cash flow challenges affected the provision of credit facilities to the SMEs sector. The multicurrency system characterized by credit market and exchange rate distortions severely affecting SMEs' ability to access finance, specifically debt capital. As reported by the majority of the respondents from the sampled institutions (96,2%) who have been financing and/or providing capacity building to SMEs, dollarisation multicurrency system affected financial institutions' capacity to continuously support SMEs financing due to severe liquidity challenges that the financial sector has been facing as shown by table 18. Banks in the country have been facing challenges such as the general illiquidity in the market, lack of long term capital, high costs of funds, low capitalization and high level of non-performing loans. These challenges eroded banks' capacity to underwrite business for SMEs due to the perceived risk.

Table 18: Dollarisation affected Banks capacity

	Frequency	**Percentage**
Yes	51	96.2
No	2	3.8

Respondents who included bankers indicated that banks started facing liquidity challenges after dollarisation multicurrency system as reported by 73,6% of the respondents due to low level of confidence in the market resulting in low level of deposits as reported by 15,1%. These liquidity challenges resulted in banks applying credit rationing specifically to the SME sector because of risk perception as shown in Table 19.

Table 19: How dollarization affected banks capacity

	Frequency	**Percentage**
Clients withdrawing	2	3.8
Client's not depositing money during dollarization	8	15.1
Bank's facing liquidity challenges	39	73.6
Other	4	7.5

As shown in table 20, the survey showed that the level of information sharing between banks and SMEs is quite moderate (as reported by 77,4%) regardless of the absence of an official Credit Registry Bureau in the country for information dissemination and sharing. Suffice to point out that while banks have managed to put in place aggressive and effective marketing strategies to communicate with their SMEs clients, ascertaining the creditworthiness and viability of SMEs projects has always remained an inherent challenge after the introduction of dollarization multicurrency system due to the absence of the much needed financial infrastructure.

Table 20: Information between banks and borrowers

	Frequency	**Percentage**
High	3	5.7
Moderate	41	77.4
Low	9	17.0

CHAPTER 5: CONCLUSION AND RECOMMENDATION

5.1 Conclusion

This research study managed to empirically test the implication of Pecking Oder model. Consistent with research objectives, the literature reviewed from international journals and other scholarly sources, the overall revelation emerging from the research findings showed that dollarization effected SMEs financing and that when SMEs require additional financing in a dollarization multicurrency system, retained earnings will be preferred over debt and that debt will preferred over new share issues to outsiders. In line with the Credit rationing and Perking Order models, SMEs in dollarized economies will find it extremely difficult to raise outside finance. Thus the overall observation established by the researcher was that the ideal source of capital in a dollarized multicurrency economy is therefore equity capital.The research findings showed that for firms to survive in a dollarized multicurrency system they will have to do it on account of their ability and capability to mobilise internal savings and equity injections.

The effect of dollarization on SME financing was attributed to factors such as the cessation of the central bank as a lender of last resort, banks facing severe liquidity constraints due to the absence of fiscal support from the international community, banks increasing credit rationing to mitigate their level of exposure to perceived risk, clients withdrawing their hard earnings from the banks and clients not depositing money due to low confidence level in the market. Again the study showed that in an effort to mitigate again default risks, banks started rationing credit to the SMEs sector after dollarization and demanding higher levels of collateral security.

The reviewed literature and research findings showed that SMEs access to bank loans was much easier before dollarization when compared to the dollarization era. This was because before dollarization, the government through the Reserve Bank of Zimbabwe (RBZ) used play a pivotal role in supporting SMEs through the unveiling of loan facilities in its monetary policy statements. However this role was virtually lost when the Reserve Bank ceased its role of lender of last resort. The research study showed that respondents were not comfortable with the idea of inviting other individuals to chip in with investment and working capital for their business ventures due to the risk of dilution of ownership. However, despite the level of fear to the idea, SMEs indicated that in order to ameliorate the current SME financing challenges under the current macroeconomic environment, they would rather prefer an institutional investor as opposed to an individual investor to help in financing their business ventures.

2. Recommendations

Whilst the study has shown that Equity (own personal savings and retained earnings) is the ideal source of capital in a dollarized economy, it is essential to consider other innovative sources of equity capital. Winborg and Landstrom (2000) pointed out that considering other innovative sources of finance other than just the traditional sources (retained earnings) is essential for SMEs growth and transformation. Consistent with the literature review, the researcher recommends Venture Capital financing as the best possible alternative source of innovative equity financing for SMEs during financial crisis periods such as dollarized and multicurrency system.

Venture capital financing has been perceived as the panacea for SMEs growth and development by many countries around the globe. In fact the life of the venture capital industry has been ultimately dependent on success stories that have turned new bright ideas into profitable and scalable business ventures and backyard dreams into multimillion dollar operations. Countries such as Malaysia, Singapore, Taiwan and Korea present good and appealing cases of VC financing for SMEs. Good lessons that could be leant include for example exit mechanisms for venture capital markets such as initial public offering. Again the participation of International Finance Corporation (IFC) as an investor in venture capital operations in developing countries provides an excellent source financing for SMEs.

Government and the central bank should consider the setting up of VCs due to numerous benefits associated with this type of capital such as seed, start up, expansion, development or bridge financing including initial public offering (IPO).The financing model has been found to play a crucial role in the management of enterprises they fund since they work closely with the stock market to raise capital through public offerings. Thus when properly implemented VC can provide support to business start-ups through the provision of technical and managerial expertise as well as the granting of available exit strategies. In summary VC foster growth in SMEs through hands-own involvement in financing, management and technical support.

Thus apart from choosing the right source of capital, it is essential to also come up with bright ideas that can be exploited and turned into fully viable commercial enterprises. Venture capital Studies have shown that the success of SMEs in the High Performing Asian Economies (HPAEs) is mainly as a result of effective business linkages between the SMEs and large established corporates. The Japanese economy is a good example of a value chain process characterised by a strong vertical relationship (*kairetsu*) between SMEs and large corporates. Studies have shown that the majority of large corporates thriving in today's world actual utilised Venture Capital to finance their business operations when they were still in their infancy stage (Agundu and Dagogo, 2009.)

To establish successful and sustainable venture capital firms (VCFs), policy makers should put in place a sound regulatory and legal framework. To do this would entail enacting laws that specifically deal with Venture Capital creation and operations as other countries have done. Countries like Korea and German have laws that specifically govern venture capital firms' operations. Other countries with specific Venture Capital legislation are Australia, Mexico, the Netherlands and Portugal (IFC, 1986). The legal framework is critical in establishing and monitoring VC firms' operations. In the French legislation for example there is a provision that sets thresholds for paid-in capital and there is a maximum ownership limit of 30 percent for any one shareholder amongst other rules.

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ANNEXURES

Annexure- 1

QUESTIONNAIRE ON SMES FINANCING IN A DOLLARIZED: MULTICURRENCY SYSTEM

Dear Sir/Madam

Greetings. My name is Tawanda Mudamburi.

I am a research scholar in the Department of commerce, University of Cape Town pursuing a Master's Degree in Development Finance on the title "SME Financing in a Dollarized (Multicurrency System)" with reference to Zimbabwe. The research has been approved by the Faculty Ethics in the Research Committee. The information obtained here will be held in the strictest confidentiality. Neither your name nor the name of your organization will be used in any document other than for the purpose of this survey. The questionnaire will take approximately 30 minutes to complete. Thank you for agreeing to take part in this research survey which will greatly contribute towards the accomplishment of this research study.

	SECTION A: BUSINESS BACKGROUND	**(tick your selection in this column)**
Q1	Which industry mostly describes your business?	a. Manufacturing b. Agriculture c. Services d. Other (specify) -------------------------------------- ------------------------------------
Q2	How long has your enterprise been in operation?	a. Less than 5 years b. 5 to 10 years c. 10 years and more
Q3	Is your enterprise registered?	a. Yes

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		b. No
Q4	How many employees does your enterprise have?	a. Less than 5 b. 5 to 19 c. 20 to 99 d. 100 or more
	SECTION B: SMEs FINANCING	
Q5	In your opinion, what do you consider to be the main obstacle for SMEs financing?	a. Lack of business financing b. Lack of business management skills c. Lack of entrepreneurial skills d. Other (specify)---------------- ------------------------------------- ------------------------------------- -------------------------------------
Q6	Is financing the main challenge affecting the growth of your business?	a. Yes b. No
Q7	Referring to business financing, what can you say are the main problems that you encountered under the multicurrency system?	a. Difficult to get investors b. Difficult to get a bank loan c. Other (specify) -----------------------------------
Q8	Please indicate the sources of capital that you have been using after dollarization multicurrency system?	a. Internal Finance only b. External finance only c. Both internal and external finance
Q10	Did dollarization affect your access to capital?	a. Yes b. No
Q11	If yes, please specify how?	------------------------------------- ------------------------------------- -------------------------------------
Q12	Referring to sources of capital, what were the main sources for your business before dollarization (before 2009)?	a. Own savings b. Family and friends

		c. Businesses d. Bank loan e. Leasing f. Others-----------------------
Q13	Referring to sources of capital, what were the main sources of capital for your business after dollarization (from 2009)?	a. Own savings b. Family and friends c. Businesses d. Bank loan e. Leasing f. Others-------------------------
Q14	How do you compare the ease of accessing capital before and after dollarization?	**a. Before dollarization** i. Ease ii. Difficult **b. After dollarization** i. Ease ii. Difficult
Q15	Have you been getting loans from the banks after dollarization multicurrency system?	i. Yes ii. No
Q16	Is it true or false that you had more challenges in accessing loans when the country adopted a multi-currency system (dollarization)?	a. True b. False
Q17	If true, what do banks require before they can give loans to SMEs?	a. Collateral b. Business plan c. Projected financial statements d. Others (specify) ------------------------------------- -------------------------------------

Q18	If you have been facing challenges in getting a loan from the banks, would you consider having a partner to provide you with capital?	a. Yes b. No
Q19	If yes, would you prefer an individual or company to invest in your company?	**a. Individual** i. Yes ii. No **b. Company** i. Yes ii. No
Q20	After dollarization banks were more reluctant to extend loans to SMEs due to a number of reasons, please use the key below to respond, with 1-strongly disagree and 5-strongly agree. 5 ☐ 4 ☐ 3 ☐ 2 ☐ 1 ☐	
Q21	Given your own experience, what do you consider to be the ideal nature of SME financing (debt or equity) in a multicurrency system such as Zimbabwe?	------------------------------------- ------------------------------------- ------------------------------------- -------------------------------------

T. Mudamburi
Contact: 0777221392: Email: tmudamburi@gmail.com

Name of your Organization ---

Your Designation: ---

Date: ---

Annexure- 2

QUESTIONNAIRE ON SMES FINANCING IN A DOLLARIZED: MULTICURRENCY SYSTEM

Dear Sir/Madam

Greetings. My name is Tawanda Mudamburi.

I am a research scholar in the Department of commerce, University of Cape Town pursuing a Master's Degree in Development Finance on the title "SME Financing in a Dollarized (Multicurrency System)" with reference to Zimbabwe. The research has been approved by the Faculty Ethics in the Research Committee. The information obtained here will be held in the strictest confidentiality. Neither your name nor the name of your organization will be used in any document based on this survey. The questionnaire will take approximately 25 minutes to complete. Thank you for agreeing to take part in this research survey which will greatly contribute towards the accomplishment of this research study

	SECTION A: INSTITUTIONAL SUPPORT	**(tick your selection in this column)**
Q1	How long have you been in the business of supporting SMES?	Less than a year 1-3 years 3-5 years 5-10 years 10 years and above
Q2	Does your bank/ institution have a separate department for SMEs?	Yes No

Q3	Is there any form of training that was offered by your bank/institution to deal with SMEs?	Yes No
Q4	If yes, please indicate the nature of training provided.	------------------------------------- ------------------------------------- -------------------------------------
Q5	How does the SME sector help the economy?	Employment creation Balance of Trade GDP Other (specify) ------------------ ------------------------------------
Q6	In your own opinion, what do you consider to be the main obstacle for SMEs growth and development in Zimbabwe?	------------------------------------- -------------------------------------
	SECTION B: SOURCES OF FINANCING	
Q7	What do you consider to have been the main sources of capital for SMEs before dollarization (2000 to 2009)?	**Equity** Own savings Family and friends Business people Corporate investors

		Other (specify)------------ **Debt** Bank loan Trade credit Leasing Preference shares Other (specify)-------------
Q8	What do you consider to have been the main sources of capital for SMEs after dollarization (2009 to 2017)?	**Equity** Own savings Family and friends Business people Companies investing Others (specify) **Debt** Bank loan Trade credit Leasing Preference shares Others (specify)----------------
	SECTION C: DOLLARISATION ON FINANCING	
Q9	Referring to SMEs financing, did dollarization affect your lending capacity to SMEs?	Yes No
Q10	If yes, please indicate how dollarization affected your	Clients withdrawing

	lending capacity?	Money during dollarization Client's not depositing money during dollarization. Banks facing liquidity Challenges Other (specify)------------------- ------------------------------------- -------------------------------------
Q11	Referring to Q9, did the volume of loans to SMEs increased or decreased after dollarization?	Increased Decreased
Q12	Referring to Q9, did the number of SMEs accessing loans increased or decreased after dollarization?	Increased Decreased
Q13	What were the main challenges you encountered in SME lending after dollarization?	Lack of collateral Insufficient credit history High risk premiums High transaction costs Other (please specify)------------
Q14	Is it true or false that the cessation of RBZ as the lender of last resort after dollarization affected banks liquidity position?	True False

Q15	Is it true or false that banks increased credit rationing to the SME sector after dollarization?	True False
Q16	How is the level of information sharing between the bank and SMEs clients for the purpose of financing?	High Moderate Low
Q17	Do you have the following source of credit information?	Interview of loan applicant Bank records Inspection of client place of business Credit checking Inter-banking checks Credit bureau
Q18	When lending to SMEs, which of the following factors are considered by your bank?	Forecasted balance sheet and P/L Cashflow forecast Good track record Collateral security

		Business plan Long term banking relations Profitability Others (Specify)-------------------
Q19	Before dollarization if SMEs took money from the bank, where they able to pay back?	Yes No
Q20	If no, how was the level of default?	High Low
Q21	After dollarization if SMEs took money from the bank, where they able to pay back?	Yes No
Q22	If no, how was the level of default?	High Low
Q23	Referring to Q22, in which SME sector is the level of default high?	Micro Small Medium

Q24	After dollarization banks were more reluctant to extend loans to the SMEs sector due to number of reasons, please use the key below to respond, 5-strongly disagree, 4-disagree, 3-neither agree nor disagree, 2-agree, and 1-strongly agree.

	5	4	3	2	1
SMEs were facing liquidity challenges	☐	☐	☐	☐	☐
The sector was not commercial viable	☐	☐	☐	☐	☐
It was highly risky to finance SMEs	☐	☐	☐	☐	☐
SMEs did not have proper accounting	☐	☐	☐	☐	☐
SMEs small in size of loans increased transaction cost	☐	☐	☐	☐	☐
SME borrowers did not have strong financials	☐	☐	☐	☐	☐

Q25	Given your own experience, what do you think should be the ideal nature of SME financing (debt or equity) in a multicurrency system such as Zimbabwe?	------------------------------------- ------------------------------------- ------------------------------------- ------------------------------------- -------------------------------------

THANK YOU VERY MUCH FOR YOUR COOPERATION

Name of your Bank/ Support Institution: ---

Your Designation: ---

Date: ---

Contact: tmudamburi@gmail.com OR 263 712 784 001